

DEFERRED RETIREMENT OPTION PROGRAM

DROP

City of Reading
Police Department

General Information Manual

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PREFACE

This general information manual has been prepared to aid those police officers interested in the *City of Reading Police Department's Deferred Retirement Option Program (DROP)*.

The contents of this manual have been designed and written to introduce the basic principles of the program to those interested. The language appearing herein should not be interpreted or relied upon to change or modify the Police Pension Plan Ordinance and/or the **DROP** provisions appearing therein. The Ordinance including any amendments, Pennsylvania Case law, Pennsylvania Statutory law and the provisions of the Federal Internal Revenue Code shall in all cases supercede the language appearing in this manual.

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 2. Pension calculation form.
 3. General retirement advice materials.
 4. Police Pension Ordinance (see Section 5, amount of pension benefits)
 5. **DROP** application, election form, and form to establish a separate DROP account.

What Is DROP?

The Deferred Retirement Option Program (**DROP**) allows you to retire and begin accumulating your retirement benefits, without terminating employment, for up to 60 months from the date you first reach normal retirement eligibility or at a date you select. While participating in **DROP**, your monthly retirement benefits are paid to a self-directed, separate and restricted account earning tax-deferred interest while you continue to work. You do not earn additional service credit for retirement while in **DROP**.

When your **DROP** participation ends, you **must** terminate all employment with the City of Reading. At that time, you will receive payment of the accumulated **DROP** benefits, and begin receiving your monthly retirement benefit (in the same amount as determined at retirement, plus any cost-of-living increases.) For many this is the “best of both worlds,” providing both a guaranteed lifetime benefit and a lump sum to be invested by the member after **DROP** ends.

Potential Advantages Of DROP Participation:

DROP allows you to simultaneously earn a salary and to accumulate an additional tax-deferred account. It can:

1. Provide additional financial security for your retirement if your **DROP** accumulation is rolled over into an eligible retirement plan. The interest you earn on your **DROP** account may be more than enough to replace the value of your lower retirement benefit (which will be less because you stopped earning retirement service credit when you retired and entered **DROP**).
2. Provide an inheritance to someone who is not eligible for a continuing benefit under the Reading Police Pension Ordinance. Careful estate planning will help to insure the proper usage of your **DROP** accumulation after your death.
3. Provide a financial basis for you to start a new business, make a major purchase, pay off your debts, or return to school and change your career. Before using your accumulated **DROP** account for such plans, make sure you have adequate resources to insure your financial security during retirement.

Participating for the full 60 months offers the greatest financial gain from **DROP** for most people. However, if your current salary greatly exceeds other years in your average final compensation, you may wish to compare estimates before deciding upon your period of **DROP** participation. If you

work longer and participate in **DROP** for a shorter period of time, your final monthly pension payment will increase. Compare that to an estimate of your benefits if you participate in **DROP** for the full 60 months. For many, even short periods of **DROP** participation can offer sufficient financial advantages to justify serious consideration.

Join DROP And Retire Or Remain Active?

One of the most important retirement decisions you will have to make is whether or not you should join **DROP**. To assist in this decision, the Pension Administrator will provide, upon request, comparative estimates of the benefits you would receive under **DROP** versus the benefits you would receive if you continue working for the same period of time and retire without participating in **DROP**.

When you get these estimates, you should meet with your accountant, financial planner, or other trusted financial adviser to review your total financial situation, including estimated pension benefits and/or **DROP** benefits, personal investments, significant debts, and other liabilities. Give careful consideration to these decisions to insure that the choices you make will provide the best financial security for your future.

Included among the many questions you need to answer when making a decision about **DROP** participation are:

- What are your options for starting **DROP** if you wish to participate for the maximum 60 months?
- Will you be ready (both financially and emotionally) to terminate employment when your **DROP** participation ends?
- If you need to, or wish to continue working, will you continue in your current career or change your career focus? Will you work full-time or part-time?

Who Is Eligible To Join DROP?

You must be vested and eligible for normal retirement (based on your years of service) as a member of The Reading Police Department.

Beginning Date Of DROP Participation.

You may begin **DROP** participation in the month you reach your normal retirement date based upon your years of service (i.e.: a minimum of 20 complete years of service).

You may notify the Pension Administrator of your election to participate in **DROP** and the dates you have chosen to participate in **DROP** on or after you reach your normal retirement date.

When determining your normal retirement date for **DROP** eligibility, or for the 60-month participation period, you may choose to include any optional

military service you have purchased. Military buy-back is provided for in the Pension Ordinance (see attached).

Applying For DROP?

The Pension Administrator must receive your **DROP** application and election forms prior to your receipt of your first retirement pension check. Thereafter, you are ineligible to participate in the **DROP** plan. You may send in these forms prior to the date you reach your normal retirement date and plan to begin **DROP** participation (samples of both forms attached).

Length Of DROP Participation.

In most cases, you may participate for a maximum of 60 months following the date on which you first entered the **DROP** program.

If you initially elect to participate in **DROP** for less than the maximum 60 months allowable, you may extend your **DROP** participation up to the 60-month maximum if approved by the City of Reading, subject to the 1/1/07 collective bargaining agreement. However, the length of **DROP** participation must comply with any terms set forth in the FOP Contract in effect at the time the **DROP** option is exercised.

Non-Guarantee Of Employment.

Your employment status is not changed by **DROP** participation. You may quit or the City of Reading may terminate you in the same manner as before **DROP** participation.

Final Retirement.

Once your participation in **DROP** begins, your retirement is final and you cannot add service credit or change retirement options, or change the type of retirement (service versus disability) that you chose to retire under.

DROP Account Beneficiaries – Changes.

You must name a beneficiary to your **DROP** account at the time you retire and enter **DROP**. You may change your beneficiary by completing and returning a change of beneficiary form provided by the Pension Administrator.

Disabled While In DROP.

If you become disabled during **DROP** and terminate employment, you will begin to receive your monthly retirement benefit that was determined when you started **DROP**, plus any cost-of-living increases, and your **DROP** accumulation up to the point of your termination. You will not be eligible to change your type of retirement from a service retirement to a disability

retirement. This is because you have already elected for conventional retirement and are in fact retired while participating in the **DROP** program.

Cost Of Living Adjustments – DROP.

Retirement benefits that accumulate in the **DROP** will be increased by any cost-of-living adjustments provided to all retirees.

Status When DROP Ends?

The **DROP** participant and the City of Reading must verify termination of all employment. Upon verification, you will begin receiving your Police Pension monthly retirement benefits and distribution of your **DROP** account.

Your **DROP** account will be paid to you in one of three ways:

- A lump sum payment, less 20% withholding tax;
- A direct rollover; or
- A combined partial lump sum payment and partial rollover, so long as the combined amount is equal to 100% of your **DROP** Account Funds.

It is recommended that within 30 days after **DROP** ends, your **DROP** assets will be distributed in the manner you specify.

Lump Sum Distribution Election.

Prior to the end of your **DROP** participation, the City of Reading should be notified of which method of distribution you have selected: a lump-sum payment, a direct rollover, or a combined partial lump sum payment and rollover. If you terminate your **DROP** participation earlier than you originally designated, the City should be notified of your new termination date. There is no penalty for early termination.

DROP Distribution Taxation.

At the conclusion of **DROP**, if you elect to have your **DROP** assets rolled over to an eligible retirement plan (see opinion letter from law firm of Blank-Rome attached) there will be no taxes due on your **DROP** assets until you begin to withdraw these funds from the eligible retirement plan. At that point, your taxes will be based upon the amount withdrawn each year and the IRS requirements for the eligible retirement plan you have selected.

If you elect to receive a total or partial lump sum payment of your **DROP** assets, the lump sum amount will be taxed as ordinary income in the year you receive it. The City of Reading is required to withhold 20% of this amount for taxes when distributed to you. When you file your income tax

forms for that year, you may also owe additional taxes, depending on your tax bracket.

DROP Distribution – Rollover.

Generally, rollovers must be paid directly to the custodian of an eligible retirement plan as defined in the Internal Revenue Code (IRC). Eligible retirement plan examples generally include the following:

- An Individual Retirement Account described in subsection 408(a), IRC – commonly referred to as an IRA.
- An Individual Retirement Annuity.

An eligible retirement plan does not include a ROTH IRA. Please refer to the attached opinion letter from Blank-Rome, dated March 13, 2006, for more detailed and complete information regarding the tax treatment of **DROP** rollovers.

Death During DROP Participation.

If you die during **DROP**, your spouse will only be eligible to rollover your **DROP** benefits into an Individual Retirement account or other accounts as permitted by the Internal Revenue Code. Beneficiaries who are not your spouse must receive a lump sum payment, less applicable taxes. All retirees should consult their own tax advisers for answers concerning the tax law

applicable at the time the retiree or retiree's beneficiary receives his or her **DROP** Account Funds.

Divorce – DROP Account.

The provisions of the Pennsylvania Divorce Code contain certain sections specifically dealing with the equitable distribution of marital property.

Pension contributions, during the time of the marriage, constitute marital property subject to division at the time of a divorce. Your spouse may be entitled to a percentage of your pension contributions and/or a percentage of your pension when it goes into pay status after your retirement.

For many families a pension is the largest asset after the family home. Even if the pension is earned solely by the efforts of one spouse, the portion of it that was earned during the marriage is still marital property subject to division by the court.

Many courts prefer to give full rights to a pension to the party who earned it as long as the other party has received an equitable amount of income and property resulting from the marital property distribution. If, however, the pension is the primary source of income that a spouse would have and there are not other significant sources of income, the court is likely to divide rights to the pension by percentages.

Congress has passed a law facilitating division of pensions. The law allows the entry of orders by a court called **Qualified Domestic Relations Orders (QDRO)**. The orders, when properly entered by a court, require the administrator of a pension plan to send pension checks not only to the retired police officer, but also to the officer's former spouse; in such cases, each party receives a proportionate share of the whole. The court cannot order a pension check to be written before the actual retirement, nor can the court change the total amount of the pension that is due.

If you are divorced and have an approved qualified domestic relations order (QDRO) in your file, your pension and **DROP** accumulation will be distributed in one of two ways. (1) If your QDRO has been specifically prepared to address **DROP**, the Pension Administrator will follow those provisions. (2) If your QDRO was filed before **DROP** became effective or if your QDRO does not address your **DROP** accumulation, the Pension Administrator will distribute to your former spouse the required proportional share of your monthly pension at retirement (as set forth in the QDRO) and the balance of the monthly pension will be paid to the **DROP** account and will be yours in full at the time you leave the **DROP** program. After you leave **DROP** you will be paid your proportional share on a monthly basis

and your spouse will continue to be paid (monthly) the proportional share she had been paid while you participated in the **DROP**.

Divorce After Entering DROP – Beneficiary Designation.

If you are divorced after entering the **DROP**, you may remove your former spouse as **DROP** beneficiary and designate a different beneficiary.

How are Police Pensions Calculated?

The Pension administrator will calculate a prospective retiree's pension based upon his or her years of service, projected retirement date, applicable rate of pay, longevity, and applicable holidays. (See attached Pension Calculation Form)